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FARM MANAGEMENT HANDBOOK

INSURANCE

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INSURANCE DEFINED

Insurance, in whatever form, is used as a method of sharing and transfering risk to a larger group that is more adequately prepared to take risks and handle losses. Insurance coverage is based on scientific and sound mathematical probabilities where a large number of individuals or businesses share the risk of loss of the individual or individual firm. In a legal framework, it is designed to transfer risk through the payment of a premium by the insured, or the policyholder, to an insurer, through a contract of indemnity. The insurer or insurance company is a financial institution specializing in risk.

Insurance is one of many methods of sharing and transferring risk. Farm decision makers, by design, are risk takers when it comes to the operation of their business. Insurance should be used as a risk sharing mechanism in areas where the adverse event is infrequent and where the possible loss is large.

ROLE OF THE INSURANCE AGENT OR INSURANCE BROKER

There is a basic difference between an agent and a broker as to their relationship with the insurance company and the policyholder. The agent plays the agency role, representing the insurer-company. What he knows, agrees to, or any commitments he makes with the insured is assumed to be an obligation of the company he represents.

The insurance broker, on the other hand, is acting as a representative of the insured. He understands the needs or wants of the insured and satisfies these specific needs by knowing the various insurance companies that have the insurance product that will fulfill the insurance requirement of the insured. Usually the agent represents a limited number of companies, while the broker generally deals with many insurance companies. The quickest way to find out if the insurance representative is an agent or broker is to ask him, he knows what he is.

In either case, the insurer pays the commissions of the agent or broker. Usually, individuals and farmers deal with agents and larger firms use the services of the broker.

THE INSURANCE CONTRACT

The insurance contract is known as a "contract of adhesion," meaning that the insurer prepared the policy in all its details and the insured had no part in drawing up its clauses or determining the wording.

The insurance contract format for property and auto insurance coverage is standard for all insurance carriers. This makes it more convenient to deal with the various insurers because the insured is dealing in the same terms with all insurers.

This is not the situation with life and health insurance contracts where the insuring agreements are all unique to each insurer's own terminology.

The many insurance products commonly purchased by farmers include:

1. Property damage and liability insurance
2. Auto and other vehicle insurance
3. Life, health and accident insurance
4. Umbrella liability insurance
5. Annuities and other retirement plans

The characteristics of auto, property and umbrella insurance policies are considered in this article; life insurance is discussed in a separate article.

AUTO INSURANCE

There are many independent facts that are considered by the insurer when issuing automobile insurance to an insured. Those variables include:

1. Accident experience
2. Driver's education
3. Occupation
4. Miles driven past year
5. Horsepower to weight ratio of the car
6. Area where car is normally driven
7. Number of cars in family
8. Age and sex of unmarried drivers
9. Academic performance of young drivers
10. The age and repair costs of the automobile
11. The addictive habits of family members

All automobile insurance policies follow a standard format. This format is essentially the same as the property owners policy. This format is as follows: A) Declarations, B) Exclusions, C) The Insuring Agreement, D) Definitions, E) Conditions, and F) Endorsements or Riders.

The first page of the policy is the declaration. This page states the facts of the insured and outlines the insurance coverage being provided.

The remaining pages include parts of the insuring agreement which list the exclusions and definitions of the policy.

Part I - Liability
Part II - Expense for Medical Service
Part III - Physical Damage
Part IV - Protection Against Uninsured Motorists

Following the insuring agreement are a list of conditions that the insured needs to meet before the insurer can carry out its part of the insuring agreement.

There are eighteen conditions the insured must follow. Some of these conditions include: 1) Payment of premiums, 2) Notice of accident, 3) Assistance and cooperation, 4) Proof of claim, 5) Right of subrogation, etc. Item 17 of these conditions list the conditions under which the insurer can cancel the policy.

Responsibility is important in automobile insurance. The agent's opinion of risk and selection of the insured is important to the company. The agent represents the insurer and the role he plays in auto insurance is really more critical than in the case of property insurance or life insurance.

It is important to have adequate liability and property damage coverage. The limits are at least $100,000 to $300,000 on liability and in many cases, the limits should be at least a million dollars. Property damage coverage should be at least $100,000 since most people don't sue for small amounts these days.

It is sensible to have adequate coverage for expenses for medical services and protection against uninsured motorists.

Collision, comprehensive and other insurance for the owned auto are a judgemental consideration. The decision of whether to obtain such insurance is determined by the age and condition of the owned auto and by the ability of the insured to assume risk. If one has a loan on the auto, usually the creditor requires adequate collision insurance. When one looks at the cost of auto insurance, the largest share is for collision coverage. There are very little increased premium costs for high liability limits ($500,000 to $1,000,000) as compared to $100,000 to $300,000 limits which many people consider as adequate. If there is a serious accident, the plaintiff may sue for $500,000 or more. In case of an accident, you are no better than your insurance protection. What about the risk of losing your farm without adequate liability? If you carry high limits on your liability coverage, this gives the insurer the incentive to adequately represent you.

Since June 19, 1980, the legal liability of the insured has changed from contributory negligence to comparative negligence in Ohio. Now, if you are involved in an accident, you may be responsible for part of the cost of the accident even though the other party "caused" the accident. This new law places a burden on all parties in an automobile accident. You may not have caused a collision, but, you may have contributed to your injuries for example, by not using adequate safety equipment to protect you in a collision.

If you have wealth at risk, be sure to have it protected with adequate liability insurance. If you do not have substantial wealth, you should carry high limits on personal liability and property damage coverage.

PROPERTY INSURANCE

The format and the content of all property and liability insurance policies are standard. They include:

A. Declarations
B. Exclusions
C. The Insuring Agreement
D. Definitions
E. Conditions
F. Endorsements or Riders

Thus, all insurers are in agreement as to the rights and responsibili-ties of the insurer and the insured. Underwriting of a farm policy is the responsibility of the agent or agency. Underwriting determines the relative risk of your property. This is a judgement made by a C.P.C.U. (Chartered Property Casualty Underwriter). Many times the C.P.C.U. is the insurance agent. The agent represents the insurer, thus, the company is bound by the judgements made by the agent or agency. After under-writing is determined, ratings are made and premium rates are ascertained on the property in question.

Because underwriting is a matter of professional judgement, there is reason for the farmer to be aware of underwriting procedures. The insurance rating of a property may be changed if the farmer understands the procedures of underwriting and ratings and makes changes in the property to improve its rating. Some examples are: improving the condition of the buildings, relocation of fuel storage, improving the condition of the electrical wiring, etc. Thus, the idea is to reduce the risk of fire and casualty, so that the underwriter can give the property an improved rating. When improvements are made on the property which will in the owner's judgement, reduce the risk of fire and other perils, it should be brought to the attention of the insurance agent or broker. Many times, the underwriter can make suggestions that will improve the rating of your property. The difference in insurance premium costs between insurers is influenced more by the rating given the property, than by the relative costs of the various insurers based on the same rating by the underwriter.

Be sure to insure your property to at least 80% of the insurer's appraisal or understand the consequences if you do not. If you insure at less than 80% of appraisal, any repair reimbursement less than total loss can also be pro-rated at the lower percentage. Thus, if you have a $5,000 loss on a $20,000 barn, and you have insurance coverage at 50% of appraisal, the insurer is only obligated to pay $2,500 toward the loss sustained. If you insure at 80% or more, all of the costs of an insurance claim will be paid by the insurer, less any deductible amount that applies.

It is important to carry adequate liability coverage. The premium costs of high limits on liability coverage are very low in proportion to the additional protection. Many farmers carry $100,000 to $300,000 liability limits when they should be carrying $1,000,000. If you have the wealth to lose, be sure you have it protected with liability insurance at the higher limits.

UMBRELLA LIABILITY COVERAGE

Many homeowners, proprietors of businesses and professional people are now considering and carrying an additional liability insurance package that covers the insured and his immediate family on liability for any contingency that is not covered under other liability coverage carried on an auto, home, and/or business. It works like major medical insurance does in the health insurance portfolio. It becomes effective when all other liability limits are exhausted. Ask your insurance agent or broker about this liability coverage. If you are working with groups of people where liability claims could be catastrophic, this is an important consideration.

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